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SUBJECT: MAJOR MERGER IN THE WORKS IN AUSTRIAN ENERGY SECTOR

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SUMMARY

¶1. (SBU) The Austrian oil and gas giant OMV and Austria's leading electricity provider, Verbund, announced on May 10 their intention to form a new company, OMV-Verbund, by the end of 2006 or early 2007. The GoA, which holds a 51% share in Verbund and a 31% share in OMV, has blessed the merger. However, there is resistance from Austrian state governments and their energy providers, which have a significant stake in Verbund. Analysts have questioned whether the strengths of OMV - oil exploration and trading and the strengths of Verbund - providing electricity - would produce significant synergies. OMV and Verbund point to the growth potential in Southeastern and Eastern Europe as the motivating factor behind the merger. The prospect of creating a national energy champion, capable of competing on a European level, was probably the primary reason for opening merger discussions. OMV and Verbund have also most likely followed closely Gazprom's recent interest in acquiring infrastructure and downstream facilities in Europe. End Summary.

CREATING AN AUSTRIAN ENERGY GIANT

¶2. (U) The Austrian oil and gas giant OMV and Austria's leading electricity provider, Verbund, announced on May 10 their intention to merge by the end of 2006 or beginning of ¶2007. The merger would create a new energy company, OMV-Verbund, able to compete on the European level. The merged firm would have market capitalization of approximately $38 billion, total sales of $23 billion, and rank twelfth among European energy companies in terms of market capitalization.

¶3. (U) OMV is currently the largest oil and gas company in Central Europe. Verbund covers half of Austria's electricity needs, and generates half of its revenues abroad. The most likely outcome is an OMV takeover of Verbund. Pursuant to the provisions of the Austrian Takeover Act, OMV will issue an offer to the minority Verbund shareholders, i.e., the 49% non-government portion. Verbund shareholders can either sell their shares for 20% above the average rate of the past six months or buy 6.5 newly issued OMV-Verbund shares for one Verbund share.

GOVERNMENT REACTIONS

¶4. (U) The federal government controls 31% of OMV shares and holds 51% of Verbund's shares. A constitutional law

requires the government to maintain a majority stake in electricity providers. However, the two large parties, the ruling center-right People's Party (OVP) and the opposition Social Democrats (SPO), have agreed to pass legislation amending this requirement, thus ensuring the two-thirds majority necessary for a constitutional change. Finance Minister Karl Heinz Grasser and SPO shadow Finance Minister Christoph Matznetter have also stated that the GoA should retain at least 25% plus one share (blocking minority) in the new company to guarantee Austria's "energy supply security."

¶5. (U) Minister of Economy Martin Bartenstein expressed support for the merger, claiming it would "create an energy player with European dimensions." Joerg Haider, leader of the junior partner in the government coalition, the Alliance Future Austria (BZO), criticized the planned merger as "a sell-out of Austria's hydropower sources." Haider cautioned that renouncing the government's majority in Verbund would be a breach of the coalition agreement between the OVP and BZO.

MERGER NEEDS SHAREHOLDER AND EC APPROVAL

¶6. (U) The Abu Dhabi-based International Petroleum Investment (IPIC), which owns 17 percent of OMV, has already blessed the deal. The IPIC's Managing Director told the press it was good business to combine gas production with electricity generation given growth in demand. With 45% of the shares of OMV-Verbund, OMV and IPIC hope this will deter any takeovers attempts from other energy giants.

¶7. (U) There is some resistance to the merger from Austrian state governments and their electricity providers who hold significant shares (nearly 30%) of Verbund. These providers are demanding more information about the putative synergy

effects of the merger, before agreeing to the merger. On May 17, the influential governor of Lower Austria, Erwin Proell, weighed in, agreeing with Haider's call to convene a special governors' conference the week of May 22 to discuss the merger. In apparent reference to IPIC and the possibility of a foreign takeover, Proell declared that Austria's hydropower should not become "a plaything for international speculators." Despite these concerns, the state governments, as minority shareholders in Verbund, cannot stop the merger, if the SPO and OVP waive the federal government's majority share.

¶8. (U) The head of the Austrian Competition Authority (ACA), Walter Barfuss, confirmed that the European Commission would need to approve the merger. Barfuss stated that he expects the EC to approve the deal with conditions. He added that the core business operations of OMV and Verbund are different, but he noted that there is some concern the merger might decrease competition in the energy sector.

¶9. (U) Apparently unrelated to the merger discussions, EU Antitrust authorities, in cooperation with the ACA, carried out an unannounced search of OMV's gas division on May 17. According to EC officials, the searches at OMV and several other major European gas companies stemmed from allegations of competition abuses, particularly restricting access to grids.

LACK OF SYNERGY BETWEEN OMV AND VERBUND

¶10. (U) Analysts expressed skepticism concerning the synergies that could develop as a result of this merger, because the gas business is not the main activity of either

company. Combining OMV's strengths - oil exploration and trading crude oil and oil products - with Verbund's forte - providing electricity - would not necessarily yield noticeable benefits.

¶11. (U) The Vienna Stock Exchange reacted negatively to the merger discussions. OMV shares have lost 16.2% since May 10, although the drop coincided with the announcement of lower than anticipated first quarter earnings. Verbund shares have lost 1.7%, although the stock has been very volatile.

THE FUTURE LIES IN GAS TRADE IN THE EAST

¶12. (U) In a joint press conference, OMV Chairman Wolfgang Ruttenstorfer and Verbund CEO Hans Haider pointed to the enormous growth potential of the new company as the real motivation behind the merger. Both companies view Southeastern and Eastern Europe as targets for expansion and increased investment. OMV has methodically built up cooperation with partners in the region, including its 2004 acquisition of 51% of Romania's Petrom and its recently concluded purchase of 34% of Petrol Ofisi, Turkey's largest gas station network. In cooperation with Italian partners, Verbund is planning to construct a gas power plant to access Libyan gas. It also runs a huge hydropower plant in Turkey.

¶13. (SBU) Analysts opined that the main driving force behind the merger is to create an Austrian energy company able to compete with larger energy giants - Germany's EON and, especially, Gazprom - in East and Southeast European markets. OMV's planned Nabucco gas pipeline from Turkey to Europe would also support the strategy of becoming a major player in the region. Verbund could use the Nabucco gas to fire power plants in Austria and Eastern Europe. Austrian press also highlighted the Russian-Ukrainian gas price war in January, emphasizing that "size matters" when a contractual dispute arises.

COMMENT

¶14. (SBU) The press and analysts have speculated for years about a possible merger of Austria's leading oil and electricity companies. However, it was never a given, as the business interests and the enterprise cultures of OMV and Verbund are indeed quite different.

¶15. (SBU) Politically, the OMV-Verbund would create a new Austrian energy champion, capable of competing on a European and global basis. OMV and Verbund undoubtedly have viewed closely Gazprom's unabashed interest in acquiring infrastructure and downstream facilities in Europe. Given

these considerations, the GoA most likely decided that a reduction in government control of the energy sector was preferable to the possibility of increased foreign competition.

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